11 April 2024

IVASS starts a second public consultation on the Draft Regulation related to unit and index linked contracts

On 28 March 2024, IVASS published for public consultation document 2/2044, which contains a draft regulation (the "**Draft Regulation**") on unit and index linked contracts, following an earlier public consultation conducted by the Institute on 11 March 2022.

In particular, the Draft Regulation is composed of provisions already subject to initial public consultation amended or supplemented following the remarks and comments made by the stakeholders, as well as a new Chapter IV-*bis*, which sets out certain exceptions to the investment limits of internal funds.

Scope of the Draft Regulation

A first important aspect concerns **the scope of the Draft Regulation**, with respect to which the stakeholders in the first public consultation paid particular attention in view of the extension of the future regulatory framework to EU companies operating under the freedom to provide services or the freedom of establishment.

To such regard, although various remarks has been made on these aspects - also on the basis of specific provisions and principles contained in the Solvency II framework - the new Draft Regulation **will also be applicable to EU companies** operating in the territory of the Italian Republic, with the sole exception to certain provisions pertaining to governance matters[1]. Therefore, should such a framework be confirmed also in the final version of the Regulation, such companies would be subject, with reference to the future class III contracts issued, to the same restrictions on the selection of the assets underlying the insurance contract and on the concentration limits currently applicable to domestic insurance companies.

To summarize, IVASS aims to ensure a level playing field between national and European insurance companies operating in this sector and, more generally, to ensure a sufficient level of protection for natural persons as policyholders.

Demographic risk

With respect to the version initially under public consultation, the Draft Regulation amended certain provisions concerning the underwriting of **demographic risk**. In this regard, the Draft Regulation specifies that linked contracts must provide for a commitment to liquidate indemnities in relation to the demographic guarantee depending on **an assessment of such risk appropriately calibrated to the policyholder's insurance needs**.

In addition, the Draft Regulation adds a further provision (applicable to domestic insurance companies and non-EU insurance companies with a branch in Italy) according to which "***the benefit to be paid by the company** [...] **shall not be less than a reasonable percentage of the premium invested**, taking into account the policyholder's need for insurance cover*".

It should be noted that such a provision, as explained by IVASS itself in the Report to the Draft Regulation, also takes into account the evaluations already expressed (and the remarks received) in Discussion Document 1/2022, in which IVASS had expressed its intention to introduce certain obligations for insurance companies to provide for an adequate increase in the countervalue of the investment in the case of the death of the insured

[1] Reference is in particular made to Articles 5(2) et seq. (detailing companies' obligations on governance and POG matters related to demographic risk), 7(1) (concerning the approval by the company's governing body of the fund rules and amendments thereto), 17 (mandatory internal fund documents), 31-ter (safeguards for managing the risks associated with the instruments in which the internal fund is invested), 32(5) (on the establishment of the mandatory register relating to unit-linked UCITS transactions), 34 (on the segregation of assets relating to individual internal funds or external UCITS) and 37 (on assets covering technical provisions).

in the event of class III contracts, considering in particular whether to provide for criteria based on a significant percentage of the net premium paid or on the increase in the market value of the underlying assets.

Furthermore, the provisions would be in line with a recent Supreme Court ruling (namely, Supreme Court Sec. I, Feb. 12, 2024, no. 3758), in which the Court affirmed (in accordance with some previous rulings) that unit-linked policies, in order to be qualified as an insurance contract, has to provide for the underwriting of demographic risk, an element that, according to the Court's reasoning, occurs only to the extent that the policy "*really attributes to a future event linked to human life the capacity to affect the insurer's performance, recognizing in any case to the insured person an appreciable sum not linked to financial risk*".

As a consequence, only those class III contracts defined as "guaranteed" or "partial guarantee" (by which is meant those policies in which the insurer underwrites - with different graduations - a demographic risk proportionate to the premiums paid) could actually be qualified as life insurance contract. Otherwise, “pure” unit-linked policies, in which there is no actual assumption of demographic risk by the company and the investment risk is borne entirely by the insured person, could not fall within the scope of Article 2(2) of the Private Insurance Code.

Derogations to investment limits

As per investment and concentration limits, the Draft Regulation essentially introduces a **specific exemption from the general investment limits for internal funds** linked to unit-linked policies **marketed to certain categories of natural persons policyholders**, also in the light of the numerous comments received on this subject during the public consultation.

In this respect, and in order to protect the interests of clients with greater knowledge and expertise, risk profile and financial resources, Article 31-*bis* of the Draft Regulation provides that an internal fund may invest *(i)* up to 40% of its total assets in certain unlisted financial instruments, including closed-ended AIFs, *(ii)* up to 30% of its total assets in the same non-reserved open-ended AIF and *(iii)* up to 50% of its total assets in non-reserved open-ended AIFs.

The above exemptions to the asset allocations would only apply to unit-linked contracts marketed to **natural persons with appropriate financial expertise and knowledge** and which provide for the payment of an initial **single** (and non-fractional) **premium** of **€500,000** and a **minimum holding period consistent with the level of illiquidity of the assets in which internal funds are invested**.

With respect to the provisions illustrated above, which constitute the most important element of the new version of the Draft Regulation, it should be emphasized that IVASS itself clarifies that it has considered, for the purposes of identifying the category of clients, the provisions of the MiFID II framework, which defines the quantitative threshold of €500,000 for the identification of professional clients.

In this regard, such a system would be deemed more appropriate with respect to both the amendments that would be made to the MiFID II Directive by the Retail Investment Strategy (which would lower the aforementioned threshold to € 250,000), and - and above all - to the provisions of Ministerial Decree 30/2015 (as amended by Ministerial Decree 1918/2022). As is well known, the aforementioned decree identifies a specific category of non-professional clients - so-called 'semi-professional' clients - who may invest in closed-end and reserved AIFs, as part of the advisory service and to the extent that the investment is not less than € 100,000.

This decision, although it constitutes a considerable step forward in favor of the diversification of the insurance offer and, therefore, has certain positive aspects with respect to the initial version of the Draft Regulation, nevertheless ends up by creating an unlevel playing field between the insurance market and the market of investment funds, given that a given client, within the limits of the provisions of Ministerial Decree 30/2015, could subscribe to units/shares of a reserved AIF, but could not (indirectly) access the same AIF through the investment in the policy, where the requirements set out by the Draft Regulation are not met.

On the other hand, the exemptions set out in the Draft Regulation would not apply where the policyholder is a legal person, not even to the extent that such a policyholder qualifies as a professional customer (per se or on request), thus resulting in a substantial equalization between legal persons and consumers.

In this scenario, however, further corrections to the issues under consideration are appropriate, also due to the planned application of the Draft Regulation to EU companies operating in Italy.

Framework of costs

Apart from certain clarifications concerning the method of calculation of management fees and costs applicable to internal funds, the new wording of Article 10 of the Draft Regulation contains significant amendments in the case of internal funds in which units or shares of UCI are held.

Regarding the applicability of management fees by the insurance company out of the assets of the internal fund, the possibility of applying such fees is radically excluded to the extent that the investment policy of the fund envisages a "*passive type strategy based on the replication of the performance of predetermined UCITS through investment in the latter*". The Regulation Draft, in any case, confirms that the company applies management fees where it systematically and adequately provides an effective management service.

Even more restrictive limits apply to the payment of management fees where the investments of the internal funds relate to “linked” UCI, by which is meant those UCI promoted, established, or managed by companies belonging to the same group as the company issuing the policy.

In this case, fees may be charged to the extent that the insurance company provides an effective additional service to that provided by the manager, without prejudice to the obligation to establish adequate safeguards to mitigate and manage conflicts of interest. Moreover, in such cases, the internal fund may not be charged “*the costs of entrusting the management to qualified intermediaries, as well as the costs of any kind for the subscription and redemption of linked UCI*”.

In this respect, the internal fund rules specify the activities carried out that justify the receipt of management fees.

Temporary Provisions and Repeals

In response to the various comments made by market participants, the temporary provisions have been modified, and it is now envisaged that *(i)* companies must ensure gradual compliance with the provisions of the Draft Regulation, in any case within 12 months from the entry in force of the Regulation, *(ii)* the regulations of pre-existing internal funds linked to contracts entered into after the entry into force of the Draft Regulation must be adjusted within the same deadline as the one referred to above, and *(iii)* ISVAP Circular 474/2002 and Regulation 32/2009, although repealed, will nevertheless remain applicable to contracts in force prior to the entry into force of the Draft Regulation.

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